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No. 02-966

In The
Supreme Court of the United States

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PENNSYLVANIA,

Petitioner,

vs.

TEXTRON FINANCIAL CORPORATION,

Respondent.

On Petition For A Writ Of Certiorari To The Court Of Appeal Of California, Fourth Appellate District

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

National Union's petition presents the issues whether, as applied by the lower courts, the second and third *BMW* guideposts provide fair notice of the severity of the penalty likely to be imposed for prohibited conduct and meaningful guidance for appellate review of punitive damage awards. *See BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 574-575 (1996). As we demonstrated, although this court has indicated that punitive damages may exceed a low multiple of compensatory damages only in certain limited circumstances, *id.* at 582, the lower courts, like the Court of Appeal in this case, frequently uphold punitive damage awards that substantially exceed compensatory damages without regard to whether those circumstances are present. In addition, we demonstrated that although this court directed courts to look to legislatively imposed sanctions for comparable misconduct in determining whether a punitive damage award is excessive, *id.* at 583, many lower courts, like the Court of Appeal here, hold that a defendant received fair notice its conduct could subject it to a significant punitive damage award so long as similar awards had been imposed in prior cases. We explained that this analysis is circular and illogical because it ignores the fact that excessive punitive damage awards were precisely the problem that prompted this court to impose constitutional limitations on the size of punitive damage awards.

Textron's brief in opposition (Opp.) barely touches on these issues. Rather, in a fact-intensive response, it appears to argue that National Union's conduct was so egregious that the legal discussion in the petition is beside the point. However, Textron, like National Union, must

deal with the issues framed by the opinion of the Court of Appeal.

1. Textron made the same accusations of egregious conduct against National Union in the Court of Appeal and they were strenuously disputed by National Union. However, the Court of Appeal never decided whether the accusations were supported by substantial evidence. Rather, it held the $1.7 million punitive damage award was proper because there was substantial evidence that TRM International, an independent company that acted as National Union's underwriter, engaged in that conduct, and National Union was vicariously liable. App. 22-25. "In light of this conclusion it is unnecessary to consider National Union's additional claims concerning . . . alleged insufficiency of the evidence based on its own conduct." App. 25; *see also* App. 29 ("Simply describing National Union's liability as vicarious does not militate against imposing a proportionately appropriate punitive damage award against it based on TRM's wrongdoing.").

If, as Textron appears to implicitly concede, the $1.7 million punitive damage award passes constitutional muster only if National Union itself engaged in the conduct described in Textron's brief in opposition, the judgment of the Court of Appeal should be vacated and the case remanded to that court so that it can decide whether Textron's accusations are supported by substantial evidence.

2. Textron fails to respond to our argument that, as presently applied by the lower courts, the second *BMW* guidepost, the "ratio to the actual harm inflicted on the plaintiff," *see BMW*, 517 U.S. at 580, does not provide meaningful guidance for appellate review of punitive

damages. Although, as Textron notes, Opp. 14, some courts have refused to limit punitive damages to a single digit multiplier of compensatory damages, *e.g.*, *Cooper v. Casey*, 97 F.3d 914, 919 (7th Cir. 1996), other courts have struck down as constitutionally excessive punitive damage awards that greatly exceed the 4 to 1 ratio this court in *Pac. Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 23-24 (1991) held was "close to the line . . . of constitutional impropriety." *See, e.g.*, *In re Exxon Valdez*, 270 F.3d 1215, 1243-44 (9th Cir. 2001). Textron may disagree with National Union as to the correct answer, but it cannot reasonably dispute that in light of the divergent opinions in the lower courts, clarification from this court is required if the second *BMW* guidepost is to provide fair notice of the severity of the penalty likely to be imposed for prohibited conduct and meaningful guidance for appellate review of punitive damages.

3. Textron accuses National Union of inaccurately calculating the ratio between compensatory and punitive damages. Opp. 15. However, it does not challenge National Union's assertion that the ratio must be determined by looking only to the count on which punitive damages were awarded, *see Zimmerman v. Direct Fed. Credit Union*, 262 F.3d 70, 82 n.9 (1st Cir. 2001); that under California law, a punitive damage award may be based only on an award of tort damages, not contract damages, *see Myers Bldg. Indus. Ltd. v. Interface Tech.*, 17 Cal. Rptr. 2d 242, 248 (Ct. App. 1993); or that the total *tort* damages awarded in this case were $89,000 – the $61,500 in policy benefits plus interest were awarded on Textron's breach of contract cause of action, not its tort cause of action for bad faith. App. 6. Consequently, looking only to the cause of action

on which punitive damages were awarded, the ratio was 20 to 1.

4. Textron argues that the potential harm that could have resulted from the conduct in this case substantially exceeded the $89,000 in tort damages awarded by the jury. According to Textron, although its bad faith damages included only $86,000 in attorneys' fees and costs, those fees would have been substantially higher if it had paid its attorneys by the hour, rather than pursuant to a contingency agreement. Asserting that its attorneys spent over 1,500 hours to recover policy benefits, Textron says that if it had paid them on an hourly basis, its recoverable attorneys' fees, *i.e.*, its tort damages, would have exceeded $500,000. Opp. 17.

This contention is without merit. Under California law, the only attorneys' fees recoverable as tort damages in an insurance bad faith action are those fees necessarily incurred to recover policy benefits. "Fees attributable to obtaining any portion of the plaintiff's award which exceeds the amount due under the policy are not recoverable." *Brandt v. Superior Court*, 693 P.2d 796, 800, 210 Cal. Rptr. 2d 211, 215 (1985). The determination whether Textron was entitled to policy benefits presented a pure question of law – whether the policy permitted National Union to terminate Textron's rights as a loss payee without advance notice to Textron – which the trial court decided on the basis of legal briefs and oral argument. App. 6. The 1,500-plus hours of attorney time allegedly devoted to the case by Textron's attorneys were not incurred to obtain a favorable ruling on that narrow legal issue, but in order to recover punitive damages by establishing a complicated "post-accident underwriting" scheme between TRM and Ferguson, the insured's broker.

Consequently, even if Textron's attorneys had charged by the hour, Textron's damages could not have included $500,000 in attorneys' fees because those fees would not have been attributable to obtaining policy benefits.

5. Textron also argues that the potential harm from the conduct in this case exceeded $89,000 because (a) the denial of coverage caused Ko to declare bankruptcy, Opp. 17, and (b) if the bus accident had caused personal injuries, and if the TRM/Ferguson post-accident underwriting scheme had succeeded, there would have been no insurance coverage for those injuries. Opp. 17-18. The contention is without merit for several reasons.

First, there was no evidence that the denial of the claim for the damage to the bus caused Ko's bankruptcy.

Second, even if the post-accident underwriting scheme had succeeded, the National Union policy still would have provided coverage for any personal injuries suffered in the accident. Under California law, liability coverage for a commercial vehicle remains in effect until 30 days after the Public Utilities Commission receives a written notice that a policy has been canceled. Without that notice, a deletion endorsement, no matter when it is prepared, has absolutely no effect on liability coverage. Cal. Pub. Util. Code § 4667 (West 1994); *see also* Cal.Veh. Code § 34630(b) (West 2000); *Transamerica Ins. Co. v. Tab Transp., Inc.*, 906 P.2d 1341, 48 Cal. Rptr. 2d 159 (1995).

Third, and most significantly, while this court has held that a court may consider the potential as well as the actual harm from the defendant's conduct in determining whether a punitive damage award is excessive, it has nonetheless emphasized that the focus must be on the potential harm *to the plaintiff*, not to other persons who

are not parties to the lawsuit. *See, e.g., TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443, 460 (1993) (courts may "consider the magnitude of the *potential harm* that the defendant's conduct would have caused to *its intended victim* if the wrongful plan had succeeded") (first emphasis in original, second added); *BMW*, 517 U.S. at 581 (summarizing *TXO* as having "relied on . . . the harm *to the victim* that would have ensued if the tortious plan had succeeded") (emphasis added); *Cooper Indus., Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424, 435 (2001) (the relevant determination for ratio purposes is "the relationship between the penalty and the harm to the victim caused by the defendant's actions"); *see also id.* at 440 (courts must consider, among other things, "the disparity between the harm (or potential harm) suffered by the plaintiff and the punitive damages award").

While misguided, Textron's attempt to justify the ratio in this case by reference to the potential harm allegedly faced by third persons is instructive. It shows that, notwithstanding this court's prior decisions, there is still considerable confusion regarding proper application of the second *BMW* guidepost. Thus, Textron's answer demonstrates that certiorari should be granted to clarify that in applying that guidepost, a court should focus on the actual and potential harm *to the plaintiff* from the defendant's conduct, not the harm that the defendant's conduct potentially could have caused to persons who were not parties to the lawsuit.

6. Textron fails to meaningfully respond to our showing that, as applied by the lower courts, the third *BMW* guidepost, the comparison between "the punitive damages award and the civil or criminal penalties that could be imposed for comparable misconduct . . .," *BMW*,

517 U.S. at 583, similarly fails to afford the fair notice required by due process and is essentially meaningless as a check on grossly excessive punitive damages. It simply repeats the Court of Appeal's conclusion that the punitive damage award here was not constitutionally excessive when examined under that guidepost because similar awards had been imposed on insurers in prior cases. Opp. 24. Textron fails to address our argument that this analysis is circular and illogical because excessive punitive damage awards were precisely the problem this court was seeking to rectify in *BMW*, 517 U.S. 559, when it adopted three guideposts for determining whether a punitive damage award is constitutionally excessive.

Textron also refers to the statutory penalties that could be imposed for the alleged conduct in this case. Opp. 24. However, those penalties could have been imposed on National Union only if it personally engaged in the prohibited conduct. As we have shown, the Court of Appeal did not decide whether the accusation that National Union engaged in that conduct was supported by substantial evidence. Instead, it held that the punitive damage award was constitutional because National Union was vicariously liable for TRM's conduct. App. 22-25, 29. Thus, the statutory penalties cited by Textron cannot support the $1.7 million punitive damage award.

CONCLUSION

For the foregoing reasons, and for those in the petition, the petition for writ of certiorari should be granted. In the alternative, the petition should be granted, the judgment of the Court of Appeal vacated, and the case

remanded for further consideration in light of this court's decision in *State Farm Mutual Automobile Ins. Co. v. Campbell*, No. 01-1289.

Respectfully submitted,

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